United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL
WITH PROOF
OF SERVICE

75-7271

To be argued by
MARTIN R. GOLD

UNITED STATES COURT OF APPEALS

for the

SECOND CIRCUIT

POLORON PRODUCTS, INC. (with substitution applied for by Dynamark Corporation, assignee),

Plaintiff-Appellant,

v.

LYBRAND ROSS BROS. & MONTGOMERY (now known as Coopers & Lybrand),

Defendant and Third-Party Plaintiff-Appellee,

v.

POLORON PRODUCTS OF INDIANA, INC., SAMUEL LEVITT, CARL LEVITT, JAY LEVITT, DYNAMARK CORPORATION and GEORGE FEIWELL,

Third-Party Defendants.

ON APPEAL FROM AN ORDER OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF PLAINTIFF-APPELLANT POLORON PRODUCTS, INC.

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Plaintiff-Appellant,	
-against-	
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-against-	
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REPLY BRIEF OF
PLAINTIFF-APPELLANT

The only argument in the answering brief which requires reply is the assertion that the amended complaint should be dismissed for its failure to state a claim under Rule 10b-5.

Defendant-appellee Lybrand contends that the complaint is deficient in its allegation of scienter. The

District Court did not reach this issue. It dismissed the complaint solely on the basis of the two dismissal rule contained in Rule 41(a), Fed. R. Civ. P.

ARGUMENT

THE AMENDED COMPLAINT IS SUFFICIENT IN ITS ALLEGATIONS UNDER RULE 10b-5

Lybrand argues that plaintiff's claim should be dismissed, pursuant to Rule 12(b)(6), Fed. R. Civ. P., because it is technically insufficient in its allegation of scienter under Rule 10b-5. The argument is without merit. The complaint alleges detailed facts sufficient to sustain the claim and specifically charges Lybrand with fraud under Rule 10b-5. Nothing more is required.

As this Court held in Lanza v. Drexel, 479 F.2d 1277, 1304-1305 (2d Cir. 1973), a complaint under Rule 10b-5 is legally sufficient if it alleges "facts amounting to scienter, intent to defraud, reckless disregard for the truth, or the knowing use of a device, scheme or artifice to defraud." [Emphasis supplied]

In paragraphs 9-15 of the amended complaint (6A-9A)*, Lybrand's misdeeds are alleged. Lybrand is informed quite

* References are to the Appendix.

specifically that it is charged with failing to uncover substantial liabilities of Levitt Manufacturing Corporation ("LMC"), and attesting to the accuracy of a grossly deficient balance sheet which it prepared, and upon which plaintiff relied. It is then alleged that this constituted "a fraud and deceit upon the plaintiff" [Amended Complaint ¶14, 8A]. Nothing more is required.

Indeed, Lybrand has admitted important operative facts in this dispute, acknowledging that it failed to uncover substantial liabilities of LMC [Lybrand's Answer ¶15, 55A-56A]. Accordingly, if plairtiff establishes its reliance upon the Lybrand audit of LMC's books [Amended Complaint ¶¶ 9 and 13, 6A, 8A], that Lybrand's failures were sufficiently gross as to amount to incompetence, and therefore fraudulent conduct [Amended Complaint ¶14, 8A], and that plaintiff was thereby damaged [Amended Complaint ¶15, 8A], plaintiff will have sustained its case.

The requirements for a fraud action against accountants are well settled. They were delineated by Chief Judge Cardozo in the classic case of Ultramares Corporation v. Touche, 255 N.Y. 170, 174 N.E. 441 (1931). There, auditors were retained by a corporation to certify year-end accounts. Unbeknown to the accountants, principals of the business had caused fictitious receivables to be added to the corporate

books in order to camouflage the corporation's insolvency. The accountants failed to uncover the false entries and certified the corporation's false financial statements. Thereupon the corporation factored its accounts with plaintiff, Ultramares Corporation, which loaned large sums in reliance upon the certified financials. When bankruptcy ensued, the factor sued the accountants for their losses, alleging two causes of action, for negligence and for fraud.

Judge Cardozo differentiated between the two causes of action. He reasoned that if skilled accountants strive to perform their audit accurately, and carelessly overlook an item or two, the ensuing errors in the certified accounts are the result of negligence, since the certification was thought to be accurate, and the accountants had no reason to believe otherwise.

If, however, the audit is performed in a hasty, ill conceived, or incompetent manner, the resulting certification of the financials, attesting to their accuracy, is fraudulent. The accountants, by virtue of their half-hearted audit, had no knowledge of the accuracy of the financials which they represented to be correct. "Fraud", wrote Judge Cardozo, "includes the pretense of knowledge when knowledge there is none." 255 N.Y. at 179.

Similarly, as the court stated in National Surety Corporation v. Lybrand, 256 App. Div. 226, 9 N.Y.S.2d 554, 562 (1st Dep't 1939):

> "Their [Lybrand's] representations that there had been a verification of cash was a pretense of knowledge when they did not know the condition of the bank accounts and had no reasonable basis to assume that they did. This, the jury could have found amounted to at least a constructive fraud."

Since the facts which plaintiff is prepared to prove at trial establish a class example of fraud by accountants, whether common law fraud or Rule 10b-5 fraud, and since notice thereof is contained in the Complaint, it is sufficient.

Finally, it should be remembered that a complaint is to be construed liberally. Conley v. Gibson, 355 U.S. 41, 48, 78 S.Ct. 99, 103 (1957); International Controls Corp. v. Vesco, 490 F.2d 1334 (2d Cir. 1974). See also Dioguardi v. Durning, 139 F.2d 774 (2d Cir. 1944); Cooper v. North Jersey Trust Company of Ridgewood, New Jersey, 226 F. Supp. 972 (S.D.N.Y. 1964).

If the jury finds the facts to be as alleged in the Complaint, Lybrand will be held liable. Lybrand has been provided with notice of these facts, and the Complaint is therefore sufficient.

CONCLUSION

The order of the District Court dismissing the action should be reversed.

Dated: New York, New York
July 30, 1975

Respectfully submitted,

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Appellant

Of Counsel:

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Charles B. Ortner

Received 2 copies of the within
Reply Brief Plaintiff Appellant Poloron Products
this 30th day of July, 1975.

Sign [signature] Managing Clerk.

For: Bolen Hays Sklar Hayley Esq(s).

Att'ys for Third Party Defendant
Poloron Products of Indiana Inc.

Received 2 copies of the within
Reply Brief of Plaintiff Appellant Poloron Products, Inc
this 30 day of July, 1975.

Sign [redacted] Maria A Rosado Assit Managing Clerk.

For: Hugh Hubbard & Reed Esq(s).

Att'ys for Defendant and Third Party
Plaintiff - Appellee